

MICROFINANCE IN DEVELOPING COUNTRIES AND FINANCIAL CRISIS

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Abstract

Article responds to the different opinions regarding the impact of financial crisis on microfinance activities in developing countries. Opinions can be divided into three groups. The first group characterizes microfinance as an integral segment of financial industry and said that financial crisis hit the microfinance. The second group underline opposite. According to this expert group are microfinance services in developing countries largely unaffected by financial crisis. The third group microholder divides into two parts. But these parts reacts on the crisis in different ways. The issue of financial crisis is topical and interesting. Article briefly describes differences in these mentioned views. Findings are based upon previous research of selected published information and analysis of materials obtained as a by-product of the participation of experts from Institute of Tropics and Subtropics working on development projects in less developing countries (LDCs).

Key words: microfinance, financial crisis, developing countries, investor

INTRODUCTION

Financial crisis and Microfinance in LDCs

To the impact of global financial crisis on microfinance activities are interested in many renowned institutions and experts. For example Microfinance Journal released following: „The dominos of crisis-credit crunch, inflation, currency dislocates and global recession are hitting mikrofinance in very different ways, depending on location, funding structure, financial state and the economic health of their clients. While many places seem unaffected today, there is little doubt that there will be impact: integration of microfinance into the mainstream does have costs“.

An important factor affecting the micro-activity is a high degree of isolation of deposit (self-help money). In particular, it is an informal type of MFIs which are self-supporting character, with the prevailing internal initiative (Littlefield, 2008). This view is confirmed by James Tullor. The microfinance sector is not fully integrated into mainstream banking and so MFIs are partially insulated from financial markets contagion. As a result, microfinance activity in developing countries are less affected by financial crisis or by regional fluctuations in the financial system. For example, in 90s during financial crisis MFIs in Latin America and Asia relatively prospered (Tullor, 2009).

Microfinance and developed countries

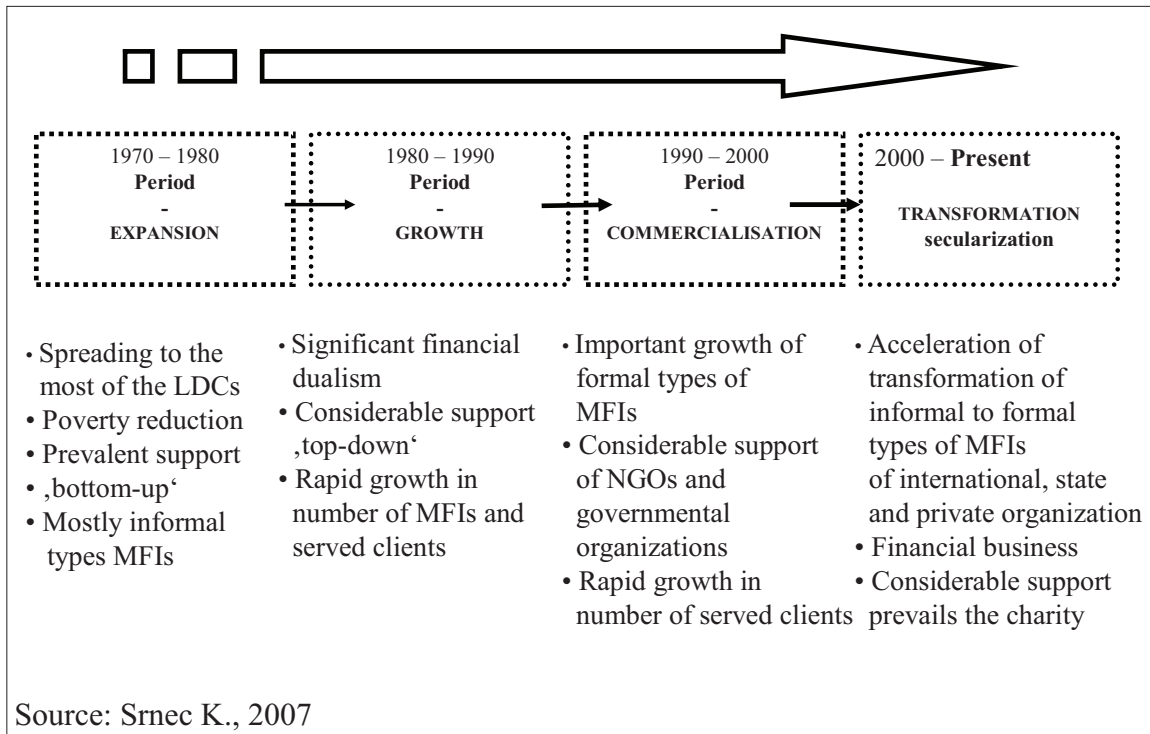
Global financial crisis surprisingly open the possibility of development microfinancial activities in developed countries, which are significantly affected by the economic recession. For example USA. Microfinance is seeking a license to open credit unions in the United States. Yunus, who opened Grameen America bank in New York a year ago, said he was seeking a US credit

union license so Grameen „can work in any state.“ Grameen America said its principal source of revenue is the interest paid by borrowers on their loans and that eventually it wanted to establish itself as a bank or credit union „with the ability to accept savings and banking deposits.“ (Financial News, 2009). This essentially means establishing of microfinance institutions as a cooperative type of credit unions or village banks. This step will strengthen the mutual liability of owners of these MFIs. The cost of provided financial services will be reducing, thereby increasing their availability. (especially for owners of financial institutions). (Fig.1)

Significant support of small farmers in the U.S. is an active approach of Farm Service Agency (FSA). The basis of this support is the extension of microfinance services, especially for small and beginning farmers. FSA provides guarantees to small farmers, especially provides basic financial services. This majority group of borrowers is not able to take a loan from commercial banks. FSA loans can be used to purchase land, livestock, equipment, feed, seed, and supplies. The nature of the system is comparable to microfinance activities in developing countries. The difference is that the economic environment is different, U.S. is a very economically developed country. Microfinance services in this environment are transparent, subject to local legislation, but also retain a strong impact of initiatives „bottom“, the initiative of small farmers, which significantly reduces the level of risk.

FSA loans are often provided to beginning farmers who cannot qualify for conventional loans because they have insufficient financial resources. FSA also helps established farmers who have suffered financial setbacks from natural disasters, or whose resources are too limited to maintain profitable farming operations (USDA, 2009). It shows that the MFIs are more

Fig. 1. Development of MFIs' activities



independent and flexible on the mainstream financial industry.

Mary Ellen Iskenderian, chief executive officer of Women's World Banking which is a global network of 54 microfinance institutions and banks in 30 countries, told TIME's Jeremy Caplan that since microfinance falls outside the mainstream economy, it tends to be resilient to global market movements. Also, there seems to still be equity available for microfinance projects. The repayment rates continue to be very high as well, around 97-98% in many places (Johnsson, 2009)

Flexibility of informal MFIs

Knowledge of ITS workers from LDCs

The above examples show that microfinance services provided by informal MFIs are not significantly affected by global financial crisis. It confirms the situation of the nineties (the financial crisis in Southeast Asia and Latin America). It should be noted that the situation at that time was different than the current. From this period to the present development took place, which can be divided into four periods.

There is an evident difference between the ninetieth years and current period. Development of micro-activities in the LDCs significantly changed the proportion of clients of informal and formal MFIs. For example the ration was 1:4 in favor of clients of informal MFIs in India in the nineties, but in the second half of the first decade of the new millennium was the formal MFIs clients more than 50% (Srnec, 2007). Behavior of the microfinance segment is in the current financial crisis inevitably different - MFIs as a whole are much more vulnerable. An exception are the informal MFIs, they are considerably more flexible. The main difference lies in the different structure of financial resources. For informal MFIs outweigh their own financial resources (self-help money). For formal MFIs foreign financial resources (mainly dominated by investors). Between the informal and formal types of MFIs are other differences which can be characterized in the following summary:

<u>Informal Microfinance institutions</u>	<u>Formal Microfinance institutions</u>
Only registered	Are incorporated under the laws of the laws of the country as a legal person
Are not transparency institutions	Transparency institutions
Are difficult impressible by Central Bank	Are adjustable by Central Bank

Management rotary manner, elected members, or collective	Normally have a professional management
Mainly own financial resources, sometimes from non-governmental aid - humanitarian organizations	Own also foreign sources
Smaller financial stability	Greater financial stability, less risk
Extremely small quantities of products	Small to medium volumes of products
Increased risk (natural influences, without insurance, without hedging, etc.)	Less risk (use of insurance, etc.)
For clients minimal interest rate	For clients interest rate is on the same level as in commercial bank
The maturity of loans (average) 95 - 99%	The maturity of loans below the level of informal MFIs
Zero or minimum profit	Achieve a profit, but below the level of commercial banks
Small variety of available financial products and services	Greater diversity of offered products and services
Local action (usually within the village)	Local or regional action
Do not to extend the territorial scope	One of the objectives is expansion

From comparison are obvious differences, which are essential factors affecting the nature of financial services. Informal types are considerably flexible and resistant to the effects of global financial crisis. (Fig.2)

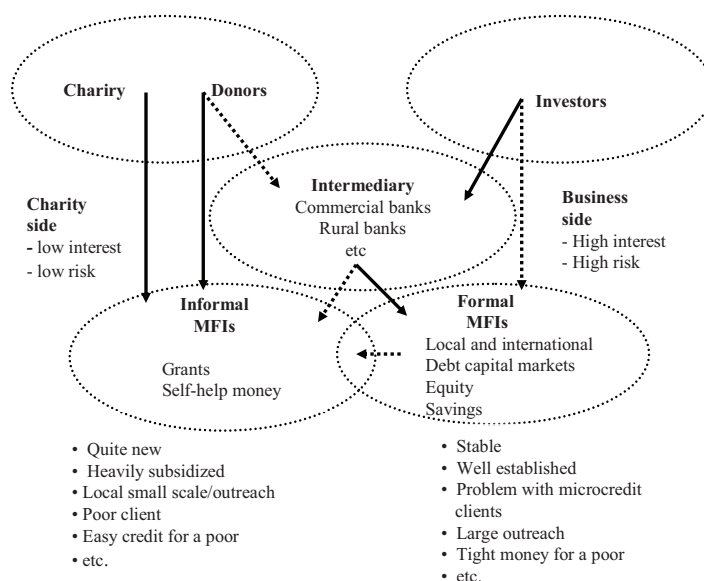
Financial dualism in LDCs

The coexistence of informal and formal financial system is characterized for the micro-activities in the LDCs- so called financial dualism. Formal sector dominates in urban areas and informal in rural areas. The formal sector is a modern, transparent and relatively less accessible to poor clients. Subject to State supervision designated as a state institutions. The informal sector is not fully transparent, it is cheap and available for very poor clients, is based primarily on the MFIs members

deposit. Poverty in these countries, in terms of funding is dealt in two basic directions:

1. Initiative from the „bottom“, the informal self-help associations, non-profit and profit MFIs
2. initiative „from above“, profit-making entities (formal MFIs, or the middle and larger financial organization)
3. From the perspective of poor people are both categories benefits. On the other hand, in terms of the needs of medium and large investors, and particularly in the application of technical development programs, it is not. In this case, partner of investors is a formal financial segment.

Fig. 2. The flow of financial resources



The above chart shows a substantial difference between the nature of the financial resources of informal and formal MFIs. It is necessary to note that the interest paid to borrowers in the final averages is for charitable side „in the range of 1 - 6%, and the “ Business Party „from 20 - 80% p.a. Given the mix of financial resources, the Business page is dependent on the overall situation of the global financial market - is not immune to the impact of the global financial crisis. Risk zone for investors is the relationship particularly between them and the intermediaries.

Business, Charity

Side by side exist small informal MFIs, mostly self-help character with the support of a charity (Charity Model) and formal MFIs with strong support NGOs (as financial intermediary), medium and large banks and other large organizations (“Business Model”). The more MFIs are integrated into the global financial system, thus are more vulnerable. On the other hand, in the normal development of the economy (the global economy is not in recession) are integrated - a formal MFIs has significantly greater impact on poverty reduction in LDCs.

„What change has a significant input of financial capital in the field of microfinance activities in poor areas?“. „Charity or Business?“ these are frequently asked questions. Both directions have their advantages. In early 2008, before the global financial crisis was based on surveys in Mexico, prepared an analysis that compares the two models. Opinions and facts supporting the development of microfinance activities, „Business Model“

- Clientele is growing rapidly (eg bank Compartamos in the period 2000 - 2008 increased from 60 thousand to about 1 000 one thousand Mexicans)
- On April 19, 2007, Banco Compartamos become the first Latin American MFI to offer equity through an Initial Public Offering (IPO)
- Shifting the financial capital of developed countries to poor and remote rural areas (see the results of MFIs type Myelen, KIWA)
- Greatly promote the sustainable development of poor rural
- Charity is not able to permanently or substantially increase the inflow of funds to poor rural
- Banks have a special incentive scheme for low-risk clients
- Interest income and profits of investors in the system are too high - it borders on usury (20 -80% pa)
- The model is a segment of the global financial market (in a stable economy, the crisis period increases the vulnerability of the Model - increases the distrust of investors)
- IPO is a transparent system, new phenomenon in microfinance, cooperation with other MFIs in the country, it is a commercial model of increasing the impact, extent and quality of services provided

Views in support of the way „model of Charity“

- It works to reduce extreme poverty, where access to external financial resources are very complicated
- On the microfinancial market works high degree of asymmetry of information - it borders on moral hazard (strongly manifested in the „business model)
- It is less stable, in many cases charitable organizations change the operation region
- Informal MFIs are based on the liability of its members - the clients and reduce the risk
- Interest rates are at the minimum
- Payment discipline is almost perfect (the influence of the mutual liability self-help groups)
- The model is more or less immune to the negative impact of financial crisis.

The analysis supports the model of „Business“ During the depression is vulnerable as everyone else in the global financial market as a integrated financial segment. This is due mainly by reducing the amount of investment funds (Crespo-Stupková, 2008).

CONCLUSION

In general, the global crisis affected LDCs, in particular in the field:

1. depression in the domestic financial markets
2. reduction in export earning
3. reductions in financial flows to LDCs

The of the today’s global crisis are likely to be more complex, deeper, and more difficult to evaluate and predict than past.

In the changed economic environment thus providing its services to MFIs. The financial resources of each type of MFIs (formal - informal) have a different character and composition (financial dualism, two models of „Business“ and „Charity“), is due to the financial dualism.

MFIs are being impacted in very different ways mainly:

- You can not compare the impact of local financial crisis in the nineties to the current crisis (Asia | Latin Americas - other external conditions, the structure of other MFIs)
- During the currency crises is East Asia and the banking crises in Latin America in the 1990s, institutions serving poor customers generally performed better financially than mainstream banks.
- The microfinance sector is not fully integrated into mainstream banking, MFIs are relatively resistant to the negative effects of global financial
- The MFIs operating with a greater proportion of external financial resources („business model“ and international funders) are more influenced by the economic recession.

- If MFIs will maintain relative independence from external financial resources are in some areas almost untouched
- Informal MFIs are generally less adversely affected by the external financial crisis, some areas of sub-Saharan Africa are almost unaffected
- Investors, mainly from developed countries reduce the volumes of financial resources, thereby limited the volume of financial services (especially in formal types of MFIs)
- Is obvious difference between the impact of global recession between locations (depending on the predominant type of MFIs)

The issue of the article will be certainly thoroughly analyzed in the future. It is clear that, despite the temporary advantages of informal MFIs, the future is in the formal system. Following the growth of economic maturity of the country will grow microfinancial integration to the official financial system of each State and to the global world system.

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